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No. 614

IN THE

Supreme Court of The United States

October Term, 1962

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

vs.

FEDERAL POWER COMMISSION,
MICHIGAN CONSOLIDATED GAS COMPANY,
COUNTY OF WAYNE, MICHIGAN,
MICHIGAN PUBLIC SERVICE COMMISSION,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioner, Panhandle Eastern Pipe Line Company, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in the above entitled case on June 30, 1962.

OPINIONS BELOW

The opinion of the Court of Appeals, dated June 30, 1962 (App., *infra*, pp. A1 - A9), is reported in 305 F. 2d 763; its prior opinion setting aside the Commission's 1954 order is reported *sub nom. City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810 (1955), certiorari denied, 352 U.S. 829. The 1954 opinion of the Federal Power Commission (R. 500-558) is reported at 13 F.P.C. 53; its 1961 opinions

(R. 422-455, 486-494, 562-566, 567-569) are reported at 25 F.P.C. 787, 1215, 784 and 1214, respectively.

JURISDICTION

The judgment of the Court of Appeals was entered on June 30, 1962 (App. *infra*, p. A10). By order of Mr. Justice Black, petitioner's time for filing the petition for a writ of certiorari was extended to November 27, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether, in determining just and reasonable rates under the Natural Gas Act, the Federal Power Commission is required to use the cost rate base method as a point of departure or basis of comparison for fixing the allowance for gas produced by a pipeline company, even though the resulting adverse effect upon pipeline production is contrary to the public interest in an adequate and economical gas supply.

2. Whether, assuming that the cost rate base method must be used as a point of departure, the Commission is required as a matter of law to disallow the cost of an exploration and development program needed to maintain deliverability from Panhandle's own production because Panhandle, solely due to its uncertainty whether these expenditures would be allowed, had not spent these moneys during the rate period; and if not, whether such a holding rests upon a rational foundation.

STATUTE INVOLVED

Section 4 of the Natural Gas Act, 15 U.S.C., § 717c, 52 Stat. 822, provides, insofar as pertinent here, that the Federal Power Commission shall prescribe "just and reasonable" rates.

STATEMENT

Petitioner, Panhandle, owns and operates an integrated natural gas pipeline system extending from Texas to Michigan and is a natural gas company subject to regulation by the Federal Power Commission under the Natural Gas Act. In connection with the operation of its pipeline system, Panhandle sells for resale in interstate commerce natural gas, some of which Panhandle has itself produced from leases owned by it and the remainder of which Panhandle has purchased from other producers.

Panhandle's First Rate Filing. In 1951, Panhandle, which at that time produced about 23 percent of the gas sold by it for resale in interstate commerce (R. 508-9), filed new rate schedules with the Commission (Docket No. G-1116).[1] After hearings, the Commission, in an opinion issued on April 15, 1954 (Opinion No. 269; R. 508-38), allowed Panhandle the then weighted average field price of 8.44 cents per Mcf for its own produced gas (R.513).[2]

In providing this allowance, the Commission declined to apply the cost rate base method to such gas produced by Panhandle. That method, the Commission found, not only resulted in "the economic incongruity" of different rates from the same well and field depending upon the original cost to each producer, but it failed "to encourage the discovery and development of this limited and irreplaceable natural resource" which the consumers have come increasingly to rely on as a major source of energy (R. 530-31, 534).

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[1] These rates became effective subject to refund in February, 1952, after suspension for the 5-month period provided by Section 4(e) of the Gas Act, 15 USC 717c (e).

[2] This is the average arm's length price for all gas sold at the wellhead to major pipeline companies, under old or new contracts, in the Panhandle and Hugoton fields from which Panhandle's pipeline receives gas, weighted in accordance with the amount of gas covered by each sale.

Moreover, the Commission found that it was in the public interest to encourage natural gas production by pipelines, "as distinguished from their complete dependence for gas supply upon purchases from other producers" (R. 534). Such production benefits the ultimate customers in the form of lower rates in at least two ways: first, by strengthening the pipeline's bargaining position, such production enables the pipeline "in negotiating gas purchase contracts *** to buy gas more advantageously," and second, by providing a cushion to absorb seasonal and other peak demands, such production permits the pipelines to take their purchased gas at relatively uniform volumes and high load factors with resulting lower unit costs (R. 534-535). In addition, with such production, there is greater assurance of continued adequacy of service than if the pipelines were wholly dependent upon purchased gas supplies (R. 535).

Finding further that the Commission's past application of the cost rate base method to pipeline-produced gas was a factor contributing to the marked decline in the ratio of pipeline-produced gas sold in interstate commerce, both generally and specifically as to Panhandle itself (R. 536), the Commission concluded:

> "* * * the ultimate public interest will be better served by permitting the pipeline to receive for the gas which it produces a price reflecting the weighted average arm's-length payments for identical natural gas in the fields (and sometimes from the very same wells) where it is produced than through the application of the 'rate-base' method to this commodity.* * *" (R. 537).

On review, the court below did not deny the Commission's power to deviate from the cost rate base method of evaluating the gas produced by Panhandle, nor that the Commission could properly consider the desirability of encouraging exploration and development of gas by pipelines. *City of Detroit* v. *F.P.C.*, 230 F. 2d 810, 814-816 (1955).

However, the court ruled that the Commission was bound to use the cost rate base method at least as a "point of departure", stating (230 F. 2d at 817-818):

> "* * * If the Commission contemplates increasing rates for the purpose of encouraging exploration and development, or the ownership by pipeline companies of their own producing facilities, it must see to it that the increase is in fact needed, and is no more than is needed, for the purpose. Further than this we think the Commission cannot go without additional authority from Congress.
>
> "* * * when we refer to an 'increase' we mean an increase in the rates above those which would result from use of the conventional rate base method. For, though we hold that method not to be the only one available under the statute, it is essential in such a case as this that it be used as a basis of comparison. It has been repeatedly used by the Commission, and repeatedly approved by the courts, as a means of arriving at lawful — 'just and reasonable' — rates under the Act. Unless it is continued to be used at least as a point of departure, the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms 'just and reasonable' to some recognizable meaning."

Since the court was of the opinion that there was neither evidence nor finding by the Commission as to whether the average field price allowed exceeded the amount allowable under the cost of service formula by no more than the amount actually needed to encourage exploration and development by Panhandle, the Court held the Commission's decision "fatally defective" (230 F. 2d at 818), and remanded the case for further proceedings (230 F. 2d at 823). Certiorari was denied on October 8, 1956, 352 U.S. 829, respondent City of Detroit having argued, *inter alia*, that because the case had been remanded to the Commission for the introduction of additional evidence, "at this juncture of

the proceedings the case is not ripe for review by this Court" (Brief in Opposition, pp. 8-12).

The Second Rate Filing. Since its costs continued to increase, Panhandle on June 30, 1954, again filed new rate schedules, which, as amended, became effective subject to refund on January 1, 1955 (Docket No. G-2506; R. 422-423) and which remained in effect until August 31, 1958.[3] Hearings on these new rates were begun before the decision of the court below in the *Detroit* case, *supra* (R. 424; Tr. 1-573). However, after that decision and again, after the issuance of the Examiner's decision in this proceeding, the Commission permitted the submission of additional evidence (R. 424, 426; Tr. 574-5164).[4]

In these hearings Panhandle introduced evidence, similar to that supporting the Commission's prior findings, showing that it was in the public interest for pipeline companies to explore for and produce gas, and that the cost rate base method discouraged such exploration (R. 88-92, 82-85). These conclusions were confirmed by Panhandle's own actions. Thus, during the period in which it believed the cost rate base method to be controlling, Panhandle drilled only those wells which were necessary to protect against the expiration of leases in proven areas or against drainage by producers on adjacent properties (R. 75-77). However, during the years 1954 through 1956 when the Commission had departed from the cost rate base method for the gas produced by Panhandle, Panhandle had undertaken extensive exploratory activities (R. 77-81), which it discontinued

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[3] Effective as of September 1, 1958, Panhandle filed new and higher rate schedules to reflect further cost increases. As a result, Docket No. G-2506, like the earlier proceeding in Docket No. G-1116, now concerns not future rates but rates for a closed or "locked-in" period.

[4] The remanded proceeding on the first rate filing was actually never reopened for the introduction of further evidence. Instead, all the evidence taken subsequent to the remand related to Panhandle's second rate filing of June, 1954.

following reversal of the Commission's action in the *Detroit* case (R. 82).

Accordingly, for the over-all period, 1955-1958, Panhandle's exploration and development program was not adequate to replace, during that period, the decline in petitioner's ability to deliver gas ("deliverability") from the company's owned reserves. Allowance by the Commission in its second opinion of only costs equivalent to 4.7 cents per Mcf of company-produced gas was thus substantially less than the amount necessary merely to maintain productive capacity. The additional amount necessary for this purpose was shown to be 5.65 cents per Mcf, based upon the $20,811,766 exploration and development program which was required merely to restore such loss of deliverability (R. 126-135, 259). The company committed itself to undertake this carefully engineered program if provided with the necessary allowance of 10.35 cents per Mcf (4.7 plus 5.65) (R. 168-169, 172).

Panhandle demonstrated that this allowance for Panhandle produced gas would be fair to consumers. It is far less than the 14.6-cent average price in long-term gas purchase contracts executed by Panhandle during the 1955-1958 period (Exh. 103; R. 267, 166), and the 15.5-cent average price then paid by all pipelines in the Panhandle and Hugoton fields for significant volumes of gas under contracts made during the same period (R. 139-40, 166-67).[5] In addition, during the same period the Commission allowed at least 37 filings by producers in these fields to become effective, with rates ranging from 10 cents to 15 cents but largely in the neighborhood of 12 cents (R. 482).

On April 27, 1961, the Commission issued separate opinions dealing with the first and second rate filings. In its opinion dealing with the second rate filing the Commission

[5] During the last part of 1958 and in 1959 almost all the new contracts were at prices ranging from 16 to 23 cents (Exh. 105; R. 271, 139).

found that the "difficult" test established by *City of Detroit*, which "contemplates a showing of what is needed above the cost of service in order to encourage exploration and development" (R. 432), had not been met (R. 429-433) — although it specifically declared that the amount it was allowing "will be nowhere near what appears to be required to encourage a vigorous and continuing program of exploration and development" (R. 433).

The Commission refused to accept as a measure of need, and therefore as justification for the price urged by Panhandle, the additional cost of the exploration and development program required to be undertaken during the past period in order to maintain the deliverability then needed, as well as the cost of a larger program needed to increase future deliverability. In the Commission's view, since these amounts had not actually been spent there was no justification for charging Panhandle's customers with the cost of a "hypothetical" program not undertaken even if it be assumed that "such a program was needed" (R. 430). Accordingly, while the Commission recognized that "a new approach is necessary for the pipeline producers as well as the independent producers" (R. 432), it felt impelled by *City of Detroit* to grant to Panhandle for gas produced by it only an allowance based upon the cost rate base formula, with some adjustments irrelevant here (R. 432).[6]

The Commission refused to reopen the proceeding relative to the first rate filing pursuant to the remand of the Court of Appeals in *City of Detroit*. However, it based its decision with regard to the first filing on the record made in the proceedings in the second filing, as to which the Commission stated there had been a full hearing and a full presentation of the issues (R. 562-563).

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[6] While for test year purposes, the Commission "normalized" Panhandle's *non-productive* "exploration and development" costs by averaging the annual expenditures therefor for the rate period involved, it failed comparably to "normalize" Panhandle's far greater expenditures for *productive wells*.

The Court below affirmed the Commission's decisions. See Appendix, *infra*.

REASONS FOR GRANTING THE WRIT

The Court of Appeals held in its *Detroit* decision that the Natural Gas Act required the Federal Power Commission, in fixing rates for gas produced by a pipeline company, to use the conventional cost rate base formula as a "point of departure," to be departed from only to the extent necessary to provide incentive for exploration for, and development of, further gas reserves. And by its present decision, which means that as a practical matter the departure itself must be justified by cost rate base evidence, the court below has in effect precluded even such limited departure, thereby imposing the cost rate base formula as the sole means for pricing such gas.

These holdings, we submit, are inconsistent with the prior decisions of this Court and in conflict with *Wisconsin* v. *Federal Power Commission*, 303 F. 2d 380 (App. D.C., 1961), (*Phillips*), certiorari granted, Nos. 72, 73, 74, this Term, 369 U.S. 870, in which the Court of Appeals for the District of Columbia Circuit approved, *inter alia*, the Commission's use of "area" prices — without regard to the conventional cost rate base formula — in determining rates for producer produced gas. Indeed, the position taken by the Commission in the brief it recently filed in this Court in the *Phillips* case (pp. 17-29), repudiates the rationale of *Detroit* and reasserts the reasoning of its Opinion No. 269, the decision which *Detroit* reversed.[7] In view of this conflict[8] and the importance of the problem as to the standards which the

[7] The brief suggests (p. 22) that the *Detroit* limitation applies only where the cost of service method is used for the non-producing portion of a company's operations. Such a reading of *Detroit* finds no support in the opinion itself.

[8] The principal petitions in *Phillips* asserted a conflict with the *Detroit* case as one of the grounds for certiorari. See Petitions in Nos. 754, 755, Oct. Term, 1961, at pp. 17-19 and pp. 23-24 respectively.

Commission may apply in determining the amount to be allowed producers for their gas, already recognized by the Court by its grant of certiorari in *Phillips*, certiorari is clearly warranted to review these holdings by the court below.[9]

Also meriting review by this Court is the further holding of the court below, based on the assumed validity of *Detroit*, that proof of the need for an additional allowance above that provided by the conventional cost rate base formula is limited solely to actual past expenditures allowable under that same formula. Thus, Panhandle was not permitted to charge customers for the exploration and development costs needed to replace the gas they consumed during the period the rates were in effect, notwithstanding the fact that the company assured the Commission that such exploration and development will be carried out thereafter if such costs were allowed in the rates under review. The court's affirmance of the Commission's restricted interpretation of *Detroit*, would, if valid, unjustifiably emasculate the narrow power to depart from the cost rate base formula envisioned in *Detroit*, at least for the mass of cases in which (because of the length of time F.P.C. rate cases customarily take) the period involved is terminated by the filing of a new rate before the rate for that period is finally fixed. Since this case involves many millions of dollars and affects the rates of other pipeline producers, it is apparent that certiorari is warranted on this issue as well.

Review of this case along with *Phillips* will enable the Court to deal comprehensively with the problem of pricing gas produced by regulated companies.

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[9] This Court's denial of certiorari in the *Detroit* case does not foreclose consideration of the same issue on certiorari now. *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251, 257-258; see also *Urie* v. *Thompson*, 337 U.S. 163, 172-173; *United States* v. *U.S. Smelting Co.*, 339 U.S. 186, 198-199; Robertson & Kirkham, *Jurisdiction of the Supreme Court of the United States* (Wolfson and Kurland edition, 1951), Section 35.

I. A. In *Detroit*, the court below set aside the Commission's refusal to apply the conventional cost rate base formula to gas produced by Panhandle, holding that the Commission must use that formula at least as a "point of departure." And in its present decision, that court affirmed the Commission's attempt to comply with this remand without the exercise of any independent discretion or authority unconfined by *Detroit*.

These rulings by the court below, which in substance bind the Commission to a single formula for the fixing of rates, are contrary to this Court's repeated holdings — as well as to the Commission's present position as stated in its *Phillips* brief (pp. 17-25)—"that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. ***Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling." *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602, following *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575; see, also, *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 324 U.S. 635, 649; *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 603.[10]

The error of the court below is compounded by the fact that, in setting aside the Commission's order in *Detroit*, it did not find that the rates then approved were without the area of reasonableness which the "end result" test permits. Although as just noted, this Court has stressed that the "end result" is determinative, not the "formula or combination of formulae" using in fixing rates, the court below

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[10] While in the *Colorado Interstate* and *Panhandle* cases last cited, this Court affirmed the Commission's use of the cost rate base method even as applied to the production part of a pipeline's operation, the Court carefully pointed out (324 U.S. at 601):

> "We do not say that the Commission lacks the authority to depart from the rate-base method. We only hold that the Commission is not precluded from using it."

adopted a precisely contrary approach. Its conclusion was not that the rates fixed were unjust or unreasonable but that the Commission had not used the correct formula in fixing rates, thereby in effect binding the Commission to the cost rate base formula irrespective of "end result." This is inconsistent with this Court's prior decisions, not only in improperly restricting the scope of the Commission's discretion, but in giving controlling effect to the formula used by the Commission rather than the "end result" thereof.

B. 1. The rulings by the court below also are in conflict with its approval in *Phillips* of the Commission's proposed abandonment of the cost rate base formula for fixing rates for gas produced by independent producers and the Commission's undertaking instead to establish prices for the gas itself on the so-called "area" basis (24 F.P.C. 537).[11] In addition to expressly refusing to apply *Detroit* on the ground that "nowhere in the Natural Gas Act is there as much as one word which indicates that the Commission must use a rate base in determining just and reasonable rates" (24 F.P.C. at 548), the Commission in its *Phillips* opinion pointed out that the various problems which it had encountered in attempting to fix rates based upon costs for natural gas as produced from the well — the cost of which varies from producer to producer and from well to well —

[11] Simultaneously, the Commission had issued its Statement of General Policy No. 61-1 (24 F.P.C. 818), establishing for guidance purposes on an interim basis, rates for each of twenty-three producing areas throughout the country. Except for two areas, for which only one price was provided, the Statement contained two prices for each area, one for initial service, i.e. new contracts, and the other for increases, i.e. in old or existing contracts. The Statement advised that the prices thus provided

> "*** will serve as a guide to us and to interested parties in determining whether proposed initial rates should be certificated without a price condition and whether proposed rate changes should be accepted or suspended." (24 F.P.C. at 818).

had made it virtually impossible for it effectively to fix the rates for such gas (see 24 F.P.C. at 542-548).[12]

Accordingly, the Commission stated in *Phillips* (24 F.P.C. at 542):

> "Experience of the Commission in this case, as well as in many other producer rate cases during the past five years, has shown, beyond any doubt, that the traditional original cost, prudent investment rate base method of regulating utilities is not a sensible, or even a workable method of fixing the rates of independent producers of natural gas.****"[13]

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[12] In this connection, the Commission referred (24 F.P.C. at 548) to the detailed discussion in the separate opinions of Mr. Justice Jackson in the *Hope* and *Colorado Interstate* cases of the shortcomings of the rate base method when applied to such an "elusive, exhaustible and irreplaceable" product as natural gas. See 320 U.S. 628-660, 324 U.S. 608-615. In addition, the Commission quoted the following excerpt from *Forest Oil Corp.* v. *Federal Power Commission*, 263 F. 2d 622, 626 (C.A. 5, 1959):

> "We do not think that either the Commission or the petitioner should be baffled or handicapped in this new field of regulation by any formulas by whatever name they are known. Specifically, if there is an accounting or rate-making formula known to the public utilities industry as a 'conventional rate-base method of rate-making' which the Commission in its order of dismissal in this case said must be used at least as a basis of comparison or point of departure, we say the Commission need not require it unless such method is the only way by which the Commission can make its required determination."

[13] See also Naff, *Federal Regulation of Independent Gas Producers*, 34 Tul. L. Rev. 277, 292-93 (1960); Falck, *Can Gas Producer Regulation Be Made Workable?* 66 Pub. Util. Fort. 73, 74-76 (1960); Falck, *Impact of Federal Regulation on Natural Gas Company Management*, 67 Pub. Util. Fort. 516, 518-19 (1961); Mason, *Producer Problems Under the Natural Gas Act*, 68 Pub. Util. Fort. 512, 514 (1961); Thanhouser, *Paradise Lost for Natural Gas*, 16 Bus. Law. 626, 636, 68 Pub. Util. Fort. 550, 553 (1961); 66 Pub. Util. Fort. 408-09 (1960) (excerpt from article by Clarence H. Ross, then chairman of the Section of Public Utility Law of the ABA); 57 Pub. Util. Fort. 771 (1956) (speech by F.P.C. Chairman Kuykendall); 59 Pub. Util. Fort. 123-24 (1957) speech by F.P.C. Commissioner Connole); Welch, *Is F.P.C. Gas Producer Regulation Here To Stay?* 57 Pub. Util. Fort. 505, 507-09 (1956); Tarver, *Improving the Effectiveness of F.P.C. Gas Regulation*, 68 Pub. Util. Fort. 508, 510 (1961); Abrams, *What Happens Now to F.P.C. Gas Regulation?* 57 Pub. Util. Fort. 361, 363-64 (1956); LeBoeuf, *Chaos in the Natural Gas Industry From the Distributor Viewpoint*, 44 Geo. L.J. 607, 612, 624-625 (1956); Note, *F.P.C. Regulation of Independent Producers of Natural Gas*, 75 Harv. L. Rev. 549, 555-56 (1962).

In affirming that action of the Commission, the Court of Appeals adverted to the administrative problems and the anomalous results which would flow from the application of the cost rate base formula to gas production (303 F. 2d at 383), and ruled (303 F. 2d at 387):

> "The Supreme Court has said several times that the Commission is not bound to any one method or to known methods. The regulation of gas producers is a new project. Obviously, as is cogently pointed out in this record, it presents new and complex facts and problems. It would be foolish for the courts to hold that the Commission is bound to apply to these new conditions the methods and measurements designed and used for other and different regulatory purposes. We think it is clear that the Commission had ample authority to embark upon an effort to design suitable new standards for use in the regulation of producers when it found that the tools at hand were not suited to this purpose."

2. The conflict between the *Detroit* and *Phillips* cases as to the power of the Commission under the Natural Gas Act to depart from the cost rate base formula is accentuated by the fact that both decisions deal with what is essentially the very same problem, i.e. the pricing of gas produced and sold for resale in interstate commerce. To be sure, *Phillips* involves gas produced by an independent producer and *Detroit* concerns gas produced by a pipeline company, but this factual difference is irrelevant. As this Court recently noted, "[T]he identical provisions of the Natural Gas Act regulate pipeline companies as well as independent producers" (*Sunray Mid-Continent Oil Company* v. *Federal Power Commission*, 364 U.S. 137, 143 (1960)). And, in holding producers subject to the Act in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), the Court relied, *inter alia*, upon its past decisions, i.e. cases involving the production facilities of pipeline companies (see 347 U.S. at 677

-78). Plainly, therefore, the Act vests the Commission with the same discretion with regard to pricing gas produced by pipeline companies as it does with regard to pricing gas produced by independent producers.

Similarly, as is evident from the Commission's original opinion in *Detroit* (which the court below set aside), the practical considerations which appear to underlie the action of the Court of Appeals in *Phillips* are fully applicable to gas production by a pipeline company. Thus, for example, it is just as true for the production activities of a pipeline company as it is for production by independent producers that "simply to allow producers a return on investment would penalize the efficient or fortunate and reward the inefficient or unfortunate" (303 F. 2d at 383). Likewise, the risks of discovering gas are the same for a pipeline exploring therefor as they are for the independent producer; indeed the comment, referred to by the court below (303 F. 2d at 383) that "there is little more relation between the investment and the result than in a game of poker," was made by Mr. Justice Jackson with regard to gas production by a pipeline company (see *Hope* case, *supra* at 649).

Finally, in *Phillips* the court below noted the "ridiculous results" which would flow from using cost for pricing gas produced by independent producers (303 F. 2d at 383). And in this regard the Commission pointed out (24 F.P.C. at 544) that in many fields single wells may have as many as fifty part owners; "[g]as from one well might well range in cost from 1 cent to 10 dollars per Mcf" (24 F.P.C. at 544). But Panhandle, together with other pipeline producers, also produces gas from numerous wells in which it is a part owner with other producers. In accordance with its Policy Statement 61-1 (*supra*, p. 12, fn. 11), providing 16 or 17 cents for initial sales and 11 cents where a previous rate is increased for gas produced by [illegible]

fields[14], the Commission has made effective numerous rate filings by other producers in those fields, and indeed by co-owners with Panhandle for gas produced from the very same wells, at prices ranging from 11 to 17 cents per Mcf, all without suspension, without hearing and without proof of need. Plainly, to apply to Panhandle a method of fixing the price for its produced gas, whereby it receives therefor only about 4.7 cents per Mcf, far less than the amount allowed other producers for the same product from the same fields, and even from the same wells, not only yields "ridiculous results" but is grossly discriminatory in violation of the Natural Gas Act.

The reason why the cost of service formula is inappropriate to pipeline producers such as Panhandle is well stated at page 27 of the brief for the Federal Power Commission recently filed in the *Phillips* case:

> "Under the cost-of-service method of regulation, the producer who takes the initial risk in a previously unexplored area and proves it productive will often derive the least reward, for he will presumably pay less for his leasehold rights, and therefore have a lower rate base, than those less enterprising producers who follow in his footsteps. Moreover, inasmuch as natural gas royalties earned by the owners of land are usually proportionate to the unit price of the gas sold, the traditional rate-base method would invite royalty owners to lease their properties to the least efficient producers, whose high costs would entitle them to correspondingly high rates. See R. 261.
>
> The regulation of producer rates on a cost basis entails a further anomaly. If the costs of the individual producer are the sole determinant of fair price, it is plain, the Commission observed (R. 261-262), that a rate which is reasonable for one owner of a well may be inadequate or excessive for a co-owner of the same well.

[14] Most of the gas produced by Panhandle comes from these fields.

so that gas from a single well might have widely varying price tags depending on who was selling it."

The foregoing is applicable in every respect to Panhandle, and indeed, Panhandle is one of the best examples of a producer which takes initial risks in previously unexplored or undeveloped areas. As the Commission points out, mere recoupment of the resulting lower costs in the case of successful exploration and development is inadequate as a measure of reward (or even compensation) for this highly desirable activity, particularly when the "less enterprising producers" which followed in Panhandle's footsteps are now being rewarded by area price treatment for gas which they produce from these same sources at a rate far in excess of what Panhandle has been allowed.

II. In its present decision, the court below approved the Commission's refusal, based on the conventional cost rate base formula, to permit Panhandle to charge its customers with the cost of replacing the gas which they consume in any given period of time, notwithstanding the recognition in *Detroit* that the incentive needed to encourage exploration for, and development of, new reserves was to be an amount in addition to the items included under that formula. Indeed, the holding below does not even enable Panhandle to maintain its ability to deliver gas at the same level.[15]

The Panhandle and Hugoton fields from which Panhandle draws its gas were developed by it, as well as by other companies, in the 1930's when the cost of gas acreage was $1 per acre (R. 200), as compared to $30 now (R. 111); and when drilling and other exploration costs were much lower

[15] In order to be able to keep delivering the same amount of gas, Panhandle must bring in more reserves than the quantity of gas consumed each year. The reason for this is that Panhandle's reserves are old, and as gas is taken from them, the pressure goes down. Their ability to deliver gas thus declines more rapidly than the mere number of cubic feet of gas consumed. See R. 105.

than now. Furthermore, in seeking additional gas in the 1950's it was necessary to drill deeper wells than in the 1930's, which enhanced exploration costs even more. Thus, for producers required to replace resources developed in the 1930's, the depreciation, depletion and 6% return on original costs allowable under the cost rate base formula comes nowhere near providing the money needed.

As a result the additional amount necessary to maintain deliverability at the same level must come from current revenues. Investors can properly be called upon to provide initial capital, and capital for expanding assets or resources. But investors should not be called upon year after year for new funds simply to maintain a company's capacity and assets at the same test year level; this is in essence a maintenance charge which should be borne by the present customers. If new capital were to be sought for this purpose, the effect would be continually to dilute the assets of all prior investors. This is not an appropriate item for new capital, but one which the business itself should bear out of its annual revenues.[16]

The cost of the additional exploration program needed to provide enough gas to maintain the deliverability consumed during the 1955-1958 period involved in the second rate filing was shown to be about $5,000,000 per year (Exh. 101, R. 259), which is far in excess of the amount actually allowed. See pp. 7-8, *supra*. Since the proceeding involving rates for that period was still under way when the period closed, Panhandle's right to the required allowance for exploration and development remained undetermined, but Panhandle committed itself to carry out the required de-

[16] For this reason the opinion below is mistaken in referring to "the availability of other methods of financing development" (App., p. A6, *infra*). The obtaining of new capital, the method suggested in the Commission's brief below, is not appropriate when the purpose is to maintain resources at only the test year level.

velopment during the following years.[17] Such a program plainly amounts to a legitimate deferred maintenance charge. Even though a railroad, for example, may defer from one year to the next expenditures of the sums needed to maintain its tracks and equipment in good condition, the amount which should be spent to make up for the wear and tear each year is properly chargeable to the customers for that year. This is not unfair to the customers during that period. On the contrary, if they are not so charged, they will have been given an unfair advantage in terms of lower than normal costs, while future customers will be unduly burdened by having to pay the cost of developing a deliverable supply of gas sufficient to make up for the decline in deliverability during the past period for the benefit of past customers.

The characterization of Panhandle's proposed program as "hypothetical" means simply that the program had not been carried out during the period for which the rates were being fixed. But this fact is beside the point, since there is no suggestion that the program was not needed nor that it would provide more than the amount required to maintain deliverability from Panhandle's reserves. In addition, the failure of the court below to appreciate the true purpose of the program makes it virtually impossible to meet the test judicially imposed in *Detroit* with its stress upon the conventional cost rate base formula which focuses upon the past, although it bears no necessary relationship to the present and future needs of the producer. Moreover, it results in a circular dilemma, inasmuch as the reason why Panhandle did

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[17] The court below referred to "the difficulty of insuring that the funds" from the rate increase requested "would actually go into exploration and development" (App., p. A6, *infra*). But this reason for disregarding the program — which was not a reason advanced by the Commission — is not valid. Apart from Panhandle's commitment that "if we get the dollars we will spend them for the purpose we have indicated we would" (R. 215; see also Reply Brief, p. 9), the Commission has power to condition the retention of the amount needed on its being used for such purpose.

not embark upon the exploration program was that its right to the funds needed in connection therewith was being challenged in this very proceeding.[15] A program for the expenditure of millions of dollars obviously cannot be undertaken while the right to recover the funds to be used is in dispute (R. 213, 169-70). Thus, the practical effect of the Commission's refusal to grant the allowance — with the Commission assumed "was needed" (R. 430) — is to make it impossible for Panhandle ever to receive an allowance over and above the cost rate base formula for the amount actually needed for exploration and development — even that needed merely to maintain its ability to deliver at the same level.

Since, in view of the length of time required for F.P.C. rate cases, most of these proceedings involve periods which end before the proceeding is terminated, the consequences of the Commission's holding are and will be that pipelines are producing a smaller and smaller proportion of the gas, as the Commission has already found (R. 536. See p. 4, *supra*). For under the conventional formula, the pipeline neither receives the actual sums needed to maintain its ability to deliver gas nor the additional incentive necessary to induce it to invest in such a risky enterprise as the production of gas. Yet, as the Commission further found (R. 530-538, *supra* pp. 3-4) — and the court accepted this finding in *Detroit* (230 F. 2d at 817) — to encourage the pipeline companies to explore for gas will in the long run further the public interest both in lower priced gas and in an assured supply of gas. The failure of this Court to remove the barriers raised by the decisions of the court below in this case and *Detroit* to a fair, reasonable and workable method of evaluating pipeline-produced gas thus will be seriously harmful to important public interests, as well as to the pipeline companies directly concerned.

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[15] Prior to the *Detroit* decision by the court below, Panhandle had embarked upon an extended new program of exploration which was discontinued when certiorari was denied therein (R. 82; cf. R. 35-8, 75-81).

CONCLUSION

For the above reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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November, 1962

APPENDIX

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 16583 and 16584

PANHANDLE EASTERN PIPE LINE COMPANY, PETITIONER,

v.

FEDERAL POWER COMMISSION, RESPONDENT,

MICHIGAN CONSOLIDATED GAS COMPANY; COUNTY OF WAYNE, MICHIGAN; MICHIGAN PUBLIC SERVICE COMMISSION; INTERVENORS.

On Petitions for Review of Orders of the Federal Power Commission.

Decided June 30, 1962

Before BAZELON, FAHY and WASHINGTON, Circuit Judges.

WASHINGTON, *Circuit Judge:* Petitioner Panhandle Eastern Pipe Line Company seeks to review two orders of the Federal Power Commission disallowing rate increases filed by it, and requiring it, for the periods in question, to file newly computed lower rate schedules—on the basis of which refunds to customers are to be made. The total amount of the increases, collected subject to refund, is over $40,000,000.

The earlier of the two rate proceedings before the Commission, which dealt with the period from February 20, 1952, to December 31, 1954, was the subject of this court's decision in *City of Detroit, Michigan* v. *Federal Power Commission*, 97 U.S.App.D.C. 260, 230 F.2d 810 (1955), cert. denied, 352 U.S. 829 (1956). In that case the Commission had approved rate increases sought by Panhandle, and had allowed Panhandle to include in its cost of service the so-called "field price," or "commodity value," for its own produced gas, rather than a rate for such gas com-

puted under the conventional utility cost rate base method.[1] The Commission also had ruled that Panhandle's profitable hydrocarbon extraction operations[2] at Sneed, Texas, and Liberal, Kansas, constituted a separate business, so that neither the costs nor the revenues of the extraction operations should be reflected in rates fixed for petitioner's regulated activities. We held that the record and findings did not support these rulings. While not denying the Commission's power to deviate from the traditional rate base method, we pointed out that "it is essential in such a case as this" to use the rate base approach "at least as a point of departure." *Supra* at 268, 230 F.2d

[1] In the City of Detroit case, 97 U.S.App.D.C. at 263, 230 F.2d at 813, we said:

> "The rate base is a figure representing the money prudently invested in the properties and equipment utilized in the company's transmission and production business. The percentage of profit prescribed by the Commission depends upon a variety of factors, such as the risks of the business, the necessity for attracting capital, and the desirability of lower cost of gas to the public. In order to return a profit on the rate base the rates are set high enough to recover all costs of service, including taxes, depreciation, depletion, and all operating expenses chargeable to production and transmission."

In the same case, we went on to describe the "field price" method, as follows:

> "[For Panhandle's own producing properties, the Commission] computed a 'field price' for the gas obtained from this source, based upon the 'weighted average arm's length prices' established by federally unregulated bargaining for similar gas in the fields. It then multiplied the volume of Panhandle's production by that 'field price' and included the result in Panhandle's operating expenses as an amount to be recovered through the rates. At the same time the Commission excluded from the rate base the cost of the properties which produce this gas and excluded from recoverable operating expenses the cost of producing it. The Commission states that its purpose is to allow Panhandle to receive for its own produced gas 'a price reflecting the weighted average arm's-length payments for identical natural gas in the fields (and sometimes from the very same wells) where it is produced,' instead of a return on its legitimate investment in the properties and equipment used in producing this gas." *Ibid.*

[2] In these operations, gasoline and other hydrocarbon products are removed from the natural gas stream. To some extent, such extraction can improve the efficiency of the pipeline by reducing the liquid content of the gas.

at 818. We also deemed insufficient the Commission's justification for refusing to credit Panhandle's hydrocarbon extraction revenues. Accordingly, we set aside the Commission's order and remanded it for further proceedings not inconsistent with our opinion. As to the field price issue, we permitted the Commission, "if it so desires, to seek to supplement the record and findings." *Supra* at 269, 230 F.2d at 819. On April 27, 1961, the Commission issued an opinion and order (269-A, G-1116) modifying its former opinion (269) to accord with our decision in the *City of Detroit* case. This is the first of the two orders that Panhandle here seeks to have reviewed.

Prior to this court's decision and remand in the *City of Detroit* case, Panhandle had also filed an application for increased rates to become effective August 1, 1954. These rates were suspended by the Commission in its order issued December 13, 1954, which permitted Panhandle to file substitute rates at a lower level, effective January 1, 1955. This interim order was affirmed by the Third Circuit. *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 236 F.2d 606 (1956). Panhandle's lower substituted rates were permitted to be collected under bond from January 1, 1955, through August 31, 1958. Hearings were held at various times from October 1955 to January 1957. On February 10, 1959, the Examiner rendered a decision holding, *inter alia*, that Panhandle had failed to justify an allowance greater than that computed by traditional rate base methods, and denying the rate increase which had been collected under bond. On January 14, 1960, the Commission reopened the proceedings to take additional evidence on the commodity value issue. The reopened hearings were concluded on March 11, 1960, and the Commission issued its opinion and order (Opinion 344) on April 27, 1961. This is the second of the two Commission orders here under review and contains the most lengthy expesi-

tion of the reasoning relied on in both decisions of the Commission. (269-A and 344)

Panhandle vigorously defends the rate increases it sought. It contends that in order to encourage exploration and development, and to maintain its production of gas, it should have been granted an additional allowance for this purpose above that accorded by the Commission.[3] Panhandle has two principal arguments.

First, Panhandle says the Commission erred when it found that Panhandle had not justified a claimed commodity value (weighted average field price) allowance for company produced gas, and when it denied permission to charge a rate above that computed under the cost rate base formula. Panhandle is, however, under the Commission's rulings, receiving for exploration and development an allowance covering out-of-pocket operating expenses, unproductive exploration and development expenses, and depreciation and depletion, plus a 6 per cent rate of return on its production properties.[4] Panhandle claims

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[3] It should be noted that this controversy presents a somewhat distinctive problem, in the sense that Panhandle has dual objectives—it seeks a "just and reasonable" rate and return for transporting gas for others, while at the same time, it is desirous of maintaining its own fields as a source of gas supply.

[4] Panhandle contends that there is no evidence to support the Commission's finding that Panhandle should be allowed only a 6 per cent rate of return on its production properties. In this regard, petitioner's major argument is the Commission was not entitled to use the data and conclusions relevant to the proper return for Panhandle's pipeline properties as evidence and a reference point for determining a proper return on its production operation. The Commission determined that Panhandle, as a practical matter, is an integrated producing and pipeline business financed as a unit, and that therefore the data used to calculate the rate of return for Panhandle's pipeline operation was applicable to its production properties. The Commission's decision also rests on its own analysis of petitioner's capital structure, in which it finds that to allow a 6 per cent return on Panhandle's production properties will make 12 per cent available to the owners of the common stock on the portion of equity

that these allowances are insufficient for a wasting asset industry in which costs are rising, because they do not provide the funds needed for replacing either the gas or the gas pressure consumed. Panhandle argues that the current cost of finding and replenishing its gas reserves is much more than the original cost of the gas withdrawn, so that depreciation and depletion based on original costs will not be sufficient to cover the cost of replacement. An allowance based on field price would, says Panhandle, provide a fair and proper measure of return, and an incentive to exploration and development.

Second—on a basis closely related to the first argument—Panhandle contends that it should be allowed certain development costs which it says it was entitled to incur, even though it never actually did incur them.[5] Panhandle says that it could reasonably have spent some $20,000,000 on an expanded program of exploration and development, during the period in question, beyond what it did in fact spend. This amount, when added to the amount allowed by the Commission for company-produced gas, would closely approximate an allowance based on the weighted average field price. Panhandle insists that the field-price method of computing its costs—or the equivalent method of

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attributable to production assets (R. 8416), *cf.* Phillips Petroleum Co., 24 F.P.C. 537 at 573-74, (1960), *aff'd sub nom.* State of Wisconsin v. Federal Power Commission, —— U.S.App.D.C. ——, —— F.2d ——, 30 U.S.L.WEEK 2244 (1961), *cert. granted*, 30 U.S.L. WEEK 3353 (1962), where the same allowance was given on equity. We do not think that the Commission acted unreasonably in utilizing the evidence that it did use or in its analysis of petitioner's capital structure.

[5] In its brief, Panhandle says:

"The Commission's position means that petitioner is not entitled to any additional allowance for the amount needed, as the Commission assumed it was, for exploration and development, because it did not actually spend that amount during a period when its right to receive and retain the revenue needed to support such expenditure was not recognized. But petitioner could not be expected to expend the larger amount for exploration and development before it knew that this would be reflected in its revenues."

computation based on the expense of an expanded program of exploration and development—will maintain its ability to deliver gas, and thus will benefit the consuming public.

Forceful as Panhandle's contentions are, we are not persuaded that the Commission has erred. We think that the Commission was not obliged on the record made to grant a larger allowance than it did, and that it left the door open for a more liberal treatment in future years on a more persuasive record. Certainly it was entitled to reject the claim based on hypothetical development costs not actually incurred. Especially is this so in light of Panhandle's failure in fact to carry out a full exploration program, the availability of other methods of financing development, and the difficulty of insuring that the funds from a rate increase attributable to granting the requested development allowance would actually go into exploration and development.

The issues raised here involve a delicate balancing by the Commission of the interests of the company, its shareholders, the consumer, and the public. After careful consideration, we are unable to say that the method of computation selected by the Commission was unjust, unreasonable, or not conductive to proper exploration and development. Cf. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944).[6]

[6] Panhandle urges that the Commission has misread the City of Detroit opinion. It points to the Commission's statement that the allowance being made for Panhandle's own produced gas is "nowhere near what appears to be required to encourage a vigorous and continuing program of exploration and development, but the record does not support more." (R. 8406) The Commission, we think, was not by this statement indicating any misunderstanding of the Detroit opinion, or admitting that it had treated Panhandle unfairly. It was clear that Panhandle would not commit itself to undertake an expanded program of future exploration and development unless the field price or its equivalent was allowed by the Commission for the gas produced during the refund period. It was clear also that such a program had not been carried out in that period.

Alternatively, Panhandle asks that it be allowed to include in its cost of service the amount of tax savings derived from the gas and oil depletion and intangible well-drilling costs provisions of Sections 613 and 263(c) of the Internal Revenue Code of 1954, thus translating the tax savings into additional company profits. The Commission, however, elected to treat Panhandle's rate of return as a separate question from that of tax allowances, and in effect passed on to the consumer the tax savings. In so doing, we think that the Commission acted consistently with both congressional intent and prior judicial decisions. As the Fifth Circuit said in *El Paso Natural Gas Co.* v. *Federal Power Commission*, 281 F.2d 567, 573 (5th Cir. 1960), cert. denied, sub nom. *California* v. *Federal Power Commission*, 366 U.S. 912 (1961):

> "We think, in short, that there is no statutory authority for the Commission to treat actual savings in taxes to which natural gas companies are entitled any differently than savings in any other cost of service. It is the obligation of all regulated public utilities to operate with all reasonable economies. This applies to tax savings as well as economies of management. The net result of this, of course, is that such savings as are effected are passed on to the consuming public. This we consider to be the natural and necessary consequence of rate regulation."

See also *Cities of Lexington, etc., Ky.* v. *Federal Power Commission*, 295 F.2d 109 (4th Cir. 1961).

Finally, Panhandle argues that the Commission should not have credited *all* of the revenues from the Liberal and Sneed hydrocarbon and gas extraction plants to the pipeline cost of service, and that only that proportion of the extraction business which improves the pipeline's efficiency

should be credited to the pipeline business. Put another way, Panhandle seems to claim (1) that extraction operations which improve pipeline efficiency must be treated as within the Commission's jurisdiction, while those that do not should be treated as non-jurisdictional, and (2) that when jurisdictional and non-jurisdictional operations use the same facilities, the operating cost of these facilities should be allocated between them. We have found no real authority for these propositions advanced by Panhandle. On the contrary, the treatment of the extraction revenues here utilized by the Commission has been followed in numerous cases. See, e.g., *In the Matter of City of Cleveland* v. *Hope Natural Gas Co.*, 3 F.P.C. 150, 178 (1942); *In the Matter of Cities Service Gas Co.*, 3 F.P.C. 459, 480-81 (1943). The Commission's action in both of these cases has received judicial sanction. See *Hope Natural Gas Co.* v. *Federal Power Commission*, 134 F.2d 287, 307-08 (4th Cir. 1943), reversed on other grounds, 320 U.S. 591 (1944); *Cities Service Gas Co.* v. *Federal Power Commission*, 155 F.2d 694, 703 (10th Cir.), cert. denied, 329 U.S. 773 (1946). In sum, crediting revenues such as those in issue to the operating expenses of the pipeline business is the "normal" and judicially approved method employed by the Commission. In the *City of Detroit* case, the Commission departed from this practice because it feared to base rates "in part upon the fluctuating and unregulated prices of natural gasoline and other liquid hydrocarbons." See 97 U.S.App.D.C. at 269, 230 F.2d at 819. On appeal, we stated that this was an unacceptable reason. Since the Commission had not demonstrated a basis for its conclusion that the extraction business should be treated as non-jurisdictional, we said that "credit for these revenues should be given." 97 U.S.App.D.C. at 271, 230 F.2d at

821.[7] There is little doubt that the *City of Detroit* decision would, under certain circumstances, permit the Commission to allocate costs among a company's pipeline and extraction operations. But the Commission is hardly compelled to make such an allocation. We construe the *City of Detroit* case as not foreclosing the question of allocation as a matter within the Commission's reasonable discretion. However, there is a serious doubt in this case as to whether the Commission so understood the *City of Detroit* decision. Indeed, there are strong indications that the Commission believed that *City of Detroit* requires, where extraction operations in some way improve the efficiency of a transmission system, that the entire extraction revenues be credited to the pipeline.[8]

For this reason, we will remand to the Commission to reach an independent determination, in light of our opinion in the *City of Detroit* case, as to whether there should be an allocation of the extraction plant profits at Sneed and Liberal. We find no error with regard to the remaining contentions advanced by petitioner.

So ordered.

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[7] See, also 97 U.S.App.D.C. at 270, 230 F.2d at 820, where we pointed out: "These facts regarding the usefulness of the extraction process to the transmission operations, the joint use of facilities, and the joint incurring of expenses, coupled with the obvious fact that the extraction process is incident to the over-all pipeline transmission and resale operations, clearly bring the extraction operations within the jurisdiction of the Commission."

[8] The Commission explicitly stated:

"We agree with the presiding examiner that the evidence presented by Panhandle is not sufficient to overcome the *court's holding that where the extraction of hydrocarbons improves the efficiency of and is incidental to the operation of Panhandle's transmission system, the revenues derived from such extractions should be credited to its cost of service.* Panhandle's additional evidence confirms our earlier finding that the extraction operations do improve the efficiency of the pipeline and therefore clearly come within *the rule laid down by the court.*" (R. 8410) (Emphasis added.)

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM, 1961

Nos. 16583 and 16584

PANHANDLE EASTERN PIPE LINE COMPANY, PETITIONER,

v.

FEDERAL POWER COMMISSION, RESPONDENT,
MICHIGAN CONSOLIDATED GAS COMPANY; COUNTY OF WAYNE, MICHIGAN; MICHIGAN PUBLIC SERVICE COMMISSION; INTERVENORS.

On Petitions for Review of Orders of the Federal Power Commission.

Before BAZELON, FAHY and WASHINGTON, *Circuit Judges.*

Filed June 30, 1962, JOSEPH W. STEWART, *Clerk*

JUDGMENT.

These cases came on to be heard on the record from the Federal Power Commission, and were argued by counsel.

On Consideration Whereof, it is ordered and adjudged by this court that the orders of the Commission on review herein are hereby affirmed except so far as they relate to the allocation of the extraction plant profits at Sneed, Texas, and Liberal, Kansas, to the pipeline cost of service, and that these proceedings are hereby remanded to the Federal Power Commission for further proceedings consistent with the opinion of this court.

Per Circuit Judge WASHINGTON

Dated June 30, 1962

No. 611

Office-Supreme Court, U.S.
FILED
SEP 28 1962
JOHN F. DAVIS, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1962

On Petition For a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

vs.

FEDERAL POWER COMMISSION, MICHIGAN CONSOLIDATED GAS COMPANY, COUNTY OF WAYNE, MICHIGAN, MICHIGAN PUBLIC SERVICE COMMISSION,

Respondents.

BRIEF FOR MICHIGAN PUBLIC SERVICE COMMISSION, RESPONDENT, IN OPPOSITION

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Respondents.

BRIEF FOR MICHIGAN PUBLIC SERVICE COMMISSION, RESPONDENT, IN OPPOSITION

Introduction

In Panhandle's petition for writ of certiorari, several questions have been raised in support thereof: First, Panhandle appears to attack the decision of the Court of Appeals for the District of Columbia Circuit rendered in *City of Detroit* v. *Federal Power Commission*, 230 F 2d 810, 11 PUR, 3d 113, cert. denied 352 US 829 (1955). The contention is made that the Federal Power Commission and the Court of Appeals application of the tests laid down in the *Detroit* case results, as a practical matter,

in a return to the conventional cost-rate-base method for rate-making purposes. It is suggested by Panhandle that the decision below is at variance with this Court's holdings in that the reasonableness of Panhandle's rates should be predicated on the "end results." See *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 US 591. Secondly, it is contended by Panhandle, assuming that the criteria set forth in the *Detroit* case are valid, that the Commission was not justified in allowing only actual expenditures for exploration and development of natural gas in Panhandle's cost of service. Panhandle asserts that its cost of service should include the cost of its proposed exploration program even though actual expenditures were not made.

Finally, the assertion is made that the rulings by the Court below are in conflict with its approval in the *Phillips* case (Wisconsin v. Federal Power Commission, 303 F. 2d 380) of the Commission's proposed abandonment of the cost-rate-base method for fixing rates for gas produced by independent producers and the Commission's establishment of an area-pricing policy. It is suggested that there is no rational basis for treating an independent gas producer differently than a pipeline producer.

Argument

I

The Criteria Set Forth In The Detroit Case And Reaffirmed By The Court Below Are Not Unreasonable.

In the proceedings before the Commission which culminated in the *Detroit* case, the Commission approved the rates of Panhandle in which was included in the cost of service an allowance for so-called "field price" or

"commodity value" for the natural gas produced by Panhandle. Pricing the pipeline produced gas at the higher commodity value was for the purpose of encouraging natural gas production by pipeline companies. This was a departure from past practices of the Commission, which had previously used the traditional rate-base approach in determining the rate to be charged for gas produced by a pipeline company. The City of Detroit appealed this determination to the Court of Appeals for the District of Columbia Circuit, contending that the Commission is bound under the Natural Gas Act to use the cost-rate-base method in determining just and reasonable rates. Commenting upon this contention, the Court stated (11 PUR3d 113, 121):

> "The fair field price, which as we have seen results in higher rates than would have resulted from the traditional rate base method, is not an item of cost. Its inclusion as an amount to be recouped from consumers as though it were a cost incurred by Panhandle must find some other justification within the periphery of the 'just and reasonable' standards. It is not an ingredient of any of the usual needs of a regulated utility, that is, to obtain revenues for operating expenses, for preservation of its financial integrity, for capital costs, for servicing of debt and payment of dividends, or for delayed rentals or costs of exploration and development. The commission, however, advances other factors of an economic character as justification. We may not deny these a place in the total structure underlying rates if, in a balancing of investor and consumer interests, they are brought by evidence and findings into rational relationship to what is 'just and reasonable.' And in considering whether the two interests are properly balanced we must keep in mind the basic purpose of the statute to protect consumers

from excessive rates, though at the same time the statute affords the support of public authority to the regulated utility." (Citations and footnotes omitted)

The Court further stated (pages 123 and 124):

"While as we have indicated the commission may be empowered to consider some of these factors it must also, and always, relate its action to the primary aim of the act to guard the consumer against excessive rates. If the commission contemplates increasing rates for the purpose of encouraging exploration and development, or the ownership by pipeline companies of their own producing facilities, it must see to it that the increase is in fact needed, and is no more than is needed, for the purpose. Further than this we think the commission cannot go without additional authority from Congress.

"The amount allowed Panhandle for the encouragement referred to is not shown to meet this test by any evidence and findings. Of course the rate increase attributable to producing properties might have a tendency to encourage their ownership, and perhaps also the development of new sources of production, as an even greater increase also might do. But the question is whether a lesser amount would suffice. The amount here allowed is not brought into relationship by the evidence and findings with the purposes for which it is granted except that it affords a larger revenue to Panhandle than otherwise it would have. This is not an adequate basis for bringing the resulting rates within the 'just and reasonable' standards of the act. The mere fact that the field price method is used does not

vindicate the rates. Its use can be justified only in terms of a demonstrated public interest. In this case an allowance for the desired purposes, assuming they are valid, could be included without resort to the field price system. When the latter method is used the evidence and findings must show that the increase in rates thus caused is no more than is reasonably necessary for the purposes advanced for any increase. Since there is nothing in these proceedings from which such a conclusion could be drawn, they are fatally defective. In other words, we do not substitute 'our opinions for the expert judgment of the administrators to whom Congress entrusted the decision.' We simply say that if the commission is now to abandon the treatment historically accorded pipeline-produced gas in rate making on the ground that the ultimate public interest will be better served thereby, the commission should justify it on the record." (Citations and footnotes omitted)

In effect, the Court held that the Commission was not precluded from using commodity value for pricing pipeline produced gas. However, the Court said that the cost-rate-base method must be used "as a point of departure." The *Detroit* case further stated that allowances granted by the Commission above what would be allowed under the cost-rate-base method must find some justification in the record made before the Commission. It is submitted that the above criteria are not unreasonable in setting rates for a pipeline gas producer and, as will be shown subsequently, the application of these criteria to Panhandle by both the Commission and the Court below is fully supported by the record.

II

The Record Does Not Support The Claim Of Panhandle For A Rate For Its Produced Gas Above That Allowed By The Commission.

In the *Detroit* case, the Court remanded the matter back to the Commission in order to give Panhandle an opportunity to present evidence in justification of rates above those allowable under a conventional cost-rate-base approach. Panhandle introduced evidence which purported to show that, during the period from January 1, 1955, to August 31, 1958, it substantially over-produced its gas wells. The contention was made that an additional exploration and development program should have been undertaken during this period, but was not done so because there was no assurance that the Commission would fix rates sufficiently high to underwrite this program. Panhandle argued that in order to maintain the deliverability consumed during the 1955-1958 period, it needed about $5,000,000 per year for a four-year period. Evidence was presented of a proposed expansion program for the period 1960-1964. Panhandle contends that such program is necessary in order to replace the deliverability loss during the 1955-1958 period when no substantial exploration program was undertaken. Evidence was also presented by Panhandle designed to show that no excessive rate of return would result if the proposed investments in its exploration program were made and if the Commission allowed Panhandle the commodity value of its produced gas.

These arguments, advanced by Panhandle before the Commission, were disposed of in the following manner (R 430):

> "In our opinion, Panhandle's proposed program of future expansion during the 1960-1964 period is not competent to test rates in effect January 1, 1955, to August 31, 1958, on the basis of a test year ending October 31, 1954. There is no reason why Panhandle's customers during the refund period should be charged with a future expansion program. In another proceeding in setting rates for the future, we would not necessarily hold a natural-gas company to expenditures confined to the test year. However, we are here asked to make allowance for an exploration and development program which admittedly was not carried out during the test year or the subsequent refund period and is merely proposed for a later period."

The Court below upheld the decision made by the Commission in *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 305 F 2d 763, realizing in part that the issues involved should be left to the expert judgment of the administrative agency, by stating (see page A6 of Petition):

> "Forceful as Panhandle's contentions are, we are not persuaded that the Commission has erred. We think that the Commission was not obliged on the record made to grant a larger allowance than it did, and that it left the door open for a more liberal treatment in future years on a more persuasive record. Certainly it was entitled to reject the claim based on hypothetical development costs not actually incurred. Especially is this so in light of Panhandle's failure in fact to carry out a full exploration program, the availability of other methods of financing development, and the difficulty of insuring that the funds from a rate increase attributable to granting the requested development allowance would actually go into exploration and development.

> "The issues raised here involve a delicate balancing by the Commission of the interests of the company, its shareholders, the consumers, and the public. After careful consideration, we are unable to say that the method of computation selected by the Commission was unjust, unreasonable, or not conductive to proper exploration and development."

The essence of Panhandle's position is that it should be permitted to charge against ratepayers of a prior period items in its cost of service which were not, in fact, expended during the period in question. Panhandle states that this should be done because it does not want to make these expenditures without assurances that such expenditures will be included in its cost of service. It is difficult to see how this position can be taken in the face of the following statement made by the Commission (page 7, *supra*):

> "In another proceedings in setting rates for the future, we would not necessarily hold a natural-gas company to expenditures confined to the test year."

As can be seen, the Commission declined to consider hypothetical expenditures in fixing rates involving a past period. The Commission clearly explained the peculiar position taken by Panhandle by saying (page 7, *supra*):

> ". . . we are here asked to make allowance for an exploration and development program which admittedly was not carried out during the test year or the subsequent refund period and is merely proposed for a later period."

It is patent that the Commission and the Court below have acted reasonably in not permitting rates to gas consumers to be predicated upon hypothetical costs not actu-

ally incurred by the pipeline company. Contrary to what Panhandle appears to imply, the rates approved by the Commission were not determined exclusively by reference to a conventional rate-base approach, but rather by the evidence in the record. The following significant statement is made by the Commission on this point (R 432):

> "We recognize that the test required by the court in the *City of Detroit* case is a difficult one in that it contemplates a showing of what is needed above the cost of service in order to encourage exploration and development. We think that a new approach is necessary for the pipeline producers as well as the independent producers. In this proceeding, however, we have not established an area price and Panhandle has not shown that it should be allowed the commodity price as an additional allowance over the cost of service. Panhandle must, therefore, depend upon the cost of service evidence with necessary adjustments, as a basis for determining an allowance for its own produced gas."

As indicated above, the Commission has stated unequivocally that, in a proper case, it would allow exploration and development expenditures even though not made during the test year. In fact, in the instant case the Commission did just this. The Commission actually made an upward adjustment in the exploration and development expenses to recognize those expenditures made subsequent to the test period. The Commission has also indicated that, in setting rates for the future, it would not necessarily confine its determination to matters relating to the test year. In spite of these statements and assurances, Panhandle still insists upon an allowance of proposed exploration and development expenditures in the form of commodity value for its produced gas as a prerequisite for actually making such expenditures. It is difficult to see how Panhandle can insist

on the customers paying for its exploration program prior to the time the program is undertaken. This, indeed, is a most novel position.

The above considerations sufficiently demonstrate the validity of the holding in the *Detroit* case that commodity value for gas produced by pipeline companies should be allowed only if supported by the record. The Commission and the Court below have both held that Panhandle has utterly failed to support its contention that the rates approved by the Commission should be sufficiently high enough to provide Panhandle with funds to pay for an exploration and development program, which in fact has not commenced.

III

The Commission And The Court Below's Rulings In the Instant Case Are Not Inconsistent With The Area-price Policy Approved In The Phillips Case.

Panhandle contends that there is some inconsistency between the treatment by the Commission and the Court below with respect to the pricing of gas produced by an independent producer and by a pipeline company. It is suggested that the commodity-value method advocated by Panhandle in the instant proceedings is essentially the same as the area-price policy promulgated by the Commission and approved by the Court. Therefore, it is argued that the Court below could not approve area pricing and at the same time disapprove commodity value. This would undoubtedly be true (1) if there were no material differences between the problems relating to an independent producer and those relating to a pipeline producer; and (2) if the factors which were considered in developing area pricing

are the same as those which went into the development of commodity value.

In distinguishing between the treatment of independent producers and pipeline producers, the Commission recognized the enormous difficulty involved in attempting to apply a cost-rate-base method approach to the independent producers. In addition, the Commission noted the administrative burden of attempting to extend traditional rate-making principles to several thousand independent producers of natural gas. However, as we have noted above, the Commission has not foreclosed the possibility of treating pipeline and independent producers alike in the future, if this is indicated on the basis of experience. In fact, the area-pricing policy promulgated by the Commission is on an interim basis and is subject to change.

Another weakness in Panhandle's argument as to the inconsistency of the Court's ruling in the instant case, with its determination of the *Phillips* case, is an attempt to equate commodity value with area price. The Commission's Statement of General Policy initiating area prices specifically states that it is based on considerations of all relevant facts, including cost information for all decided and pending cases, existing and historical price structures, volume of production, trends of production, price trends in the various areas over a number of years, trends in exploration and development, and trends in demand and the available markets for gas. These considerations embrace a broader scope than Panhandle's commodity value which relates to average contract prices for the sale of gas in fields where Panhandle produces gas, and which Panhandle seeks to support by hypothetical costs of its proposed exploration program. Therefore, the Commission is not inconsistent in denying commodity value and at the same time promulgating an area price policy.

Assuming, *arguendo*, that the *Phillips* and *Panhandle* cases are in conflict, this does not mean that there are, necessarily, substantive grounds for *certiorari*. In the *Phillips* case, the Commission announced a policy of area pricing applicable to independent gas producers. This policy was prospective. Commodity value is advocated by Panhandle in support of the rates collected under bond from January 1, 1955, to September 1, 1958. In effect, Panhandle is asking this Court to require the Commission to apply the commodity-value principle as of January 1, 1955, because of some alleged conflict with the *Phillips* case. However, it should be noted that the Commission did not announce its area-pricing policy until September 28, 1960. The point we are making is this: Even if there is a conflict between the *Panhandle* and *Phillips* cases, the refusal of the Court to allow commodity value, based upon the record, for a period from 1955 to 1958 is not in conflict with the *Phillips* case, since the area-pricing policy was promulgated subsequent to this period.

Conclusion

For the reasons stated, the Michigan Public Service Commission respectfully requests this Court for a denial of the petition for writ of certiorari.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 614

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,
vs.
FEDERAL POWER COMMISSION,
MICHIGAN CONSOLIDATED GAS COMPANY,
COUNTY OF WAYNE, MICHIGAN,
MICHIGAN PUBLIC SERVICE COMMISSION,
Respondents

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF RESPONDENT, COUNTY OF WAYNE, MICHIGAN, IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether, in the absence of a "final" judgment, and in the further absence of any showing by petitioner of any special reason or other "review-worthiness," a writ of certiorari should be granted.

STATEMENT OF THE CASE

Respondent, County of Wayne, Michigan, an intervenor in the case below and in the proceedings before the Federal Power Commission appertaining to that case, is impelled in the public interest to file this brief in opposition to the petition of Panhandle Eastern Pipe Line Company for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit, entered in the above-entitled cause on June 30, 1962.

In the interest of enabling this Honorable Court to decide the issue presently before it, respondent directs the Court's attention to the following pertinent matters omitted from the petition:

The proceedings culminating in the judgment, of which petitioner now seeks review by certiorari, involved not only two separate rate filings made with the Federal Power Commission in Docket Nos. G-1116 and G-2506, under which the petitioner collected charges for its own produced gas based on the so-called "field price" rather than the long-established cost rate base method, as disclosed by the petition (pp. 3, 6), but also involved revenues collected by the petitioner from its profitable hydro-carbon extraction operations at two points on its interstate transmission system.

The Commission found that these extraction operations did "improve the efficiency of the pipeline" and ordered that the revenues derived therefrom be credited to the pipeline's cost of service "thereby reducing by such amounts the cost to be recovered from ratepayers" (R. 440).

The Commission also found that the increased rates collected by petitioner under the "field price" formula were not "just and reasonable or otherwise lawful under the provisions of the Natural Gas Act" (R. 453), and, accordingly, ordered refunds for the entire period covered by the two rate filings (R. 453-455; 564-566).

The judgment below, while affirming the orders of the Commission with respect to its rejection of the "field price" formula, nevertheless remands these orders to the Commission insofar "as they relate to the allocation of the extraction plant profits at Sneed, Texas, and Liberal, Kansas, to the pipeline cost of service" (petition, pp. A7-A10). Thus, this judgment is not a "final" judgment within the meaning of the statute, and the decisions of this Court.

SUMMARY OF ARGUMENT

A. The judgment for which review by certiorari herein is sought is not a "final" judgment, inasmuch as it requires the Federal Power Commission to reach "an independent determination" on the question of whether there should be an allocation of extraction plant profits to petitioner's cost of service (petition, pp. A9, A10). In the absence of petitioner's showing of special and important reasons for the writ at this time, the petition is premature and should be denied at this juncture of the proceedings.

B. *City of Detroit v. Federal Power Commission*,[1] contrary to petitioner's assertions, is not in conflict with the decisions of this Court or other Federal courts. *Wisconsin*

[1] 230 F. 2d 810.

v. Federal Power Commission,[2] cited by the petitioner as an instance of such conflict, is readily distinguishable from the *City of Detroit* case.

C. The Circuit Court of Appeals for the District of Columbia properly held on the record before it that petitioner could not charge present customers for prospective development and exploration, and that the Federal Power Commission did not commit error in disallowing such a charge (petition, p. A6).

ARGUMENT

A. As has been stated by text writers, authorities and by this Court itself, the jurisdiction given by the statute[3] to this Court to issue writs of certiorari is one which this Court has determined should be exercised sparingly and with caution.[4]

That the granting of the writ is a matter of grace and not right is pointed up by rules of this Court which state, in part, "A review of certiorari * * * will be granted only where there are special and important reasons therefor."[5] While the original requirement of a "final" judgment for review by certiorari of cases in courts of appeal has been modified by statute,[6] nevertheless, the case must still have "review-worthiness" and involve a question of such importance that it is in the public interest to have it decided

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[2] 306 F. 2d 380.

[3] U.S.C.A. Title 28, Sec. 1254, *et seq.*

[4] *American Construction Co. v. Jacksonville, T. & K. W. Ry. Co.*, 148 U.S. 372; *In re Woods*, 143 U.S. 202.

[5] Supreme Court Rule 19.

[6] 28 U.S.C.A. 1254(1).

by this Court of last resort.' The writ will not issue "merely to accord another hearing to a party defeated in the Court of Appeals."[8]

This last statement is precisely the situation herein involved. The Court of Appeals for the District of Columbia Circuit stated in its opinion that there had been no violation of constitutional or statutory rights of the petitioner, when, on the evidence before it, the Commission repudiated petitioner's "field price" formula (A6). Thus, that court quite properly declined to substitute its judgment for that of the Commission which had acted under its statutory authority.

The Court of Appeals did, however, raise a question as to whether the Commission had properly understood its previous decision in the *City of Detroit* case, *supra*, pertaining to the allowance of extraction revenues to the cost of the pipeline service. For this reason, the court remanded the Commission's orders for further consideration of this question.

The instant proceeding is remarkably parallel to the earlier controversy involving the same parties which culminated in the *City of Detroit* case, *supra*. There, too, the same Court of Appeals had remanded an order of the Federal Power Commission, which concerned the same hydrocarbon *extraction* problem as well as petitioner's "field price" formula. The petitioner had in that case, too, sought certiorari from this Court. As the petitioner itself points out (petition, p. 5), "Certiorari was denied on October 8, 1956, 352 U.S. 829, respondent City of Detroit having argued, *inter alia*, that because the case had been remanded

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[7] *Southern Power Company v. North Carolina Public Service Company*, 263 U.S. 508.

[8] *Magnum Import Company v. Coty*, 262 U.S. 154.

to the Commission for the introduction of additional evidence, "at this juncture of the proceedings the case is not ripe for review by this Court (Brief in Opposition, pp. 8-12)."

Unfortunately for petitioner, this case is still "not ripe" for ultimate adjudication by this Court. The hydro-carbon extraction revenue problem involved herein also extant in the *Detroit* case, *supra*, has been re-submitted to the Commission for further consideration.

B. Petitioner bases one ground for the writ of certiorari in the instant case upon the fact that the decision of the Court of Appeals in the *City of Detroit* case, and in the instant proceedings are "inconsistent with the prior decisions of this Court and in conflict with the *Wisconsin v. Federal Power Commission* case (petition, p. 9).

There is no basis for this conclusion on the part of the petitioner. The Circuit Court of Appeals in the earlier *City of Detroit* case, had stated simply and succinctly, that the Commission was not bound to any particular formula, but that it should use the cost rate base "as a point of departure" when considering a different method of rate regulation. This, in effect, is what the Commission did in the *Wisconsin* case. The Commission's long-established policy of adhering to a cost rate base was again reviewed by the same Court of Appeals in the *Wisconsin* case, which held that under the peculiar circumstances of that case, the Commission could institute a new method of regulation. "The regulation of gas producers *is a new* project * * * it would be foolish for the courts to hold that the Commission is bound to apply *to these new conditions the methods and measurements designed and used for other and different regulatory purposes.*"* (Emphasis supplied.)

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* *Wisconsin v. Federal Power Commission, supra*, p. 387.

Nor can any "conflict" between the *Detroit* and the *Wisconsin* cases be inferred from the following excerpt.

> "The difference between a public utility, *such as a pipeline* rendering a service by means of a fixed plant and operation, and a producer, who discovers or buys a product where, when and under such terms as he may, and sells that product under contracts negotiated on the open market, are too evident to justify elaboration. * * *" (Emphasis supplied.)[10]

The Court itself noted that there was a material distinction between the "field price" formula in the *Detroit* case and the problem facing the Commission in the *Wisconsin* proceeding, as is evident by the following:

> "The Commission is not here proposing to accept a field price, or any other price as is. It has announced guideline rates which it deems to be, on the basis of the internal data in its files on all the operators in the several areas, fair rates for the product in those areas. Such rates, thus determined, would seem to be just and reasonable rates for the consumers of the product."[11]

C. The Circuit Court of Appeals found that the Federal Power Commission, in reviewing the "field price" formula had exercised its judgment on the evidence before it at the time. In this connection, we can do no better than quote from the Opinion of the Court itself (petition, p. A6):

> "We think that the Commission was not obliged on the record made to grant a larger allowance than it did, and that it left the door open for a more liberal treatment in future years on a more persuasive record. *Certainly it was entitled to reject the claim*

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[10] *Wisconsin v. Federal Power Commission*, p. 388.

[11] *Op. cit.*, p. 389.

based on hypothetical development costs not actually incurred. Especially is this so in light of Panhandle's failure in fact to carry out a full exploration program, the availability of other methods of financing development, and the difficulty of insuring that the funds from a rate increase attributable to granting the requested development allowance would actually go into exploration and development.

"The issues raised here involve a delicate balancing by the Commission of the interests of the company, its shareholders, the consumer, and the public. After careful consideration, we are unable to say that the method of computation selected by the Commission was unjust, unreasonable, or not conductive to proper exploration and development. Cf. *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)." (Emphasis supplied.)

In the light of the foregoing, how can Panhandle or any other party to this proceeding hold that the Federal Power Commission had abused its discretion or that it did not exercise its best judgment on the record before it?

The Court of Appeals here clearly refused to substitute its judgment for that of the Commission in the absence of a showing of an abuse of discretion.

The instant proceeding involves upwards of 40 million dollars in increased rates collected by petitioner that have been found to be unlawful. None of the principles involved in either the determination of such rates or the repudiation thereof is new, novel or judicially earth-shaking. As was said by this Court in a recent case:[12]

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[12] *Deputy v. DuPont*, 308 U.S. 488.

> "The function of this court is to resolve conflicts of jurisdiction and to settle important principles of law. The discretionary power of this court to review judgments of lower federal courts was not intended to be exercised in every case where those courts have adjudicated the conflicting claims of the parties, which involves no important principles of law and no conflict of decisions among the federal courts. Our rules adopted to carry out the policy of the statutes granting the power to bring cases here by certiorari have apprised the Bar and the public that we will not take cases fully heard and adjudicated below for the mere purpose of re-examining the correctness of the result."

In essence, all that petitioner seeks is a second review of the matter, not because the judgment fails to resolve conflicting claims or because an important legal principle is involved, but purely and simply because petitioner is unhappy over the decision of the Court of Appeals.

CONCLUSION

It is therefore respectfully submitted that this case is not a proper one for review by certiorari in this Court and the petition for a writ of certiorari should be denied.

Respectfully submitted,

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No. 614

In the Supreme Court of the United States

OCTOBER TERM, 1962

PANHANDLE EASTERN PIPE LINE COMPANY, PETITIONER

v.

FEDERAL POWER COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

[redacted]

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OPINIONS BELOW

The opinion of the Court of Appeals for the District of Columbia Circuit (Pet. App., pp. A1–A9), is reported at 305 F. 2d 763. Its prior opinion setting aside the Commission's previous order is reported *sub nom. City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810, certiorari denied, 352 U.S. 829. The present opinions of the Commission (R. 422–455, 486–494, 562–569) are reported at 25 F.P.C. 787, 1215, 784 and 1214, respectively; its previous opinion (printed in part at R. 502–561) is reported at 13 F.P.C. 53.

JURISDICTION

The judgment of the Court of Appeals, affirming the Commission's orders in part and remanding them for further proceedings on an issue not raised here, was entered on June 30, 1962 (Pet. App., p. A10). By order of Mr. Justice Black, the time for filing a petition for a writ of certiorari was extended to November 27, 1962. The petition for a writ of certiorari was filed on November 26, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, in fixing rates for a natural gas pipeline company, the Commission had a reasonable basis for concluding that the company had not justified the allowance of the weighted average field price for its own production of gas.

STATUTE INVOLVED

The pertinent provisions, Section 4(e), 15 U.S.C. 717c(e), and Section 5(a), 15 U.S.C. 717d(a) of the Natural Gas Act, are set forth in the Appendix, *infra*, pp. 19–21.

STATEMENT

The court below affirmed, with one exception not in issue here, two Commission orders disallowing increased rates collected subject to refund by Panhandle Eastern Pine Line Company during the periods from February 20, 1952, to December 31, 1954, and from January 1, 1955, to August 31, 1958. The Commission orders required Panhandle to file lower substitute rates for those periods and to make refunds of the

difference between the rates collected and those found to be just and reasonable.[1]

The proceeding involving the 1952–1954 rates had been remanded to the Commission by the Court of Appeals for the District of Columbia Circuit in *City of Detroit* v. *Federal Power Commission,* 230 F. 2d 810, certiorari denied, 352 U.S. 829. The April 15, 1954, order there reviewed had allowed about $12,780,000 of a $21,400,000 annual increase sought by Panhandle (R. 557–558). In approving the increase to that extent, the Commission (1) permitted Panhandle to include in its cost of service the so-called "field price" or "commodity value" (*i.e.*, the weighted average price then being paid independent producers in each of the same areas) of its own produced gas, instead of merely allowing the cost of producing the gas, as it would under the conventional cost of service-rate base method; and (2) treated Panhandle's profitable gasoline extraction operations at Sneed, Texas, and Liberal, Kansas, as outside its jurisdiction, including neither the costs nor the revenues of those operations in determining Panhandle's rates within its jurisdiction (R. 508–546). The court of appeals in *City of Detroit* remanded on the ground that the record and findings did not support those rulings (230 F. 2d at 823).

[1] The rates here involved were superseded on September 1, 1958, by still higher rates (R. 446), which, were, in turn, superseded by increased rate filings on March 26, 1960 and July 1, 1960. By order of July 20, 1962, the Commission approved a settlement which, except for one issue not here involved, terminated the proceedings relating to the three filings subsequent to those here at issue, lowered Panhandle's current rates, and resulted in refunds of $38,500,000 plus interest.

As the court noted, the reasons given by the Commission in 1954 for allowing Panhandle to attribute to the gas produced by it the totally unregulated weighted average field price, rather than the actual cost of finding and producing, were that the traditional cost of service method (1) tended unduly to accelerate consumption of gas, (2) did not sufficiently encourage its discovery and development, and (3) did not provide adequate incentive for the ownership of gas reserves by pipeline companies, which it deemed to be in the public interest. See 230 F. 2d at 816. While rejecting contentions by consumer interests that just and reasonable rates under the Natural Gas Act could be determined only by use of the traditional cost of service-rate base method, the court held that the Commission had not sufficiently correlated its reasons for using field price with the evidence,[2] stating (230 F. 2d at 817–818):

> While as we have indicated the Commission may be empowered to consider some of these factors it must also, and always, relate its action to the primary aim of the Act to guard the consumer against excessive rates. *If the Commission contemplates increasing rates for the purpose of encouraging exploration and development, or the ownership by pipeline companies of their own producing facilities, it must see to it that the increase is in fact needed, and is no more than is needed, for the purpose.* Further than this we think the Commission

[2] It also held that it was improper for the Commission to consider the effect of the rate level on the volume of gas consumed (230 F. 2d at 816–817).

cannot go without additional authority from Congress.

The amount allowed Panhandle for the encouragement referred to is not shown to meet this test by any evidence and findings. *Of course the rate increase attributable to producing properties might have a tendency to encourage their ownership, and perhaps also the development of new sources of production, as an even greater increase also might do. But the question is whether a lesser amount would suffice.* The amount here allowed is not brought into relationship by the evidence and findings with the purposes for which it is granted except that it affords a larger revenue to Panhandle than otherwise it would have. This is not an adequate basis for bringing the resulting rates within the "just and reasonable" standards of the Act. * * * [Emphasis added.]

In addition, the court said that "it is essential in such a case as this" to use the rate base approach "at least as a point of departure." 230 F. 2d at 818–819.

Prior to the decision and remand in the *City of Detroit* case, Panhandle had filed a new set of rates which would have resulted in annual revenues of about $12 million in excess of those approved by the Commission for the earlier period (R. 423). These increased rates were suspended until January 1, 1955. On December 13, 1954, the Commission issued an interim order dismissing the rates to the extent they reflected proposed revisions in Panhandle's rate of return, working capital, allocation of costs and rate structure. As to these items, the Commission found

that the company had shown no change in circumstances or other justification for departing from the Commission's findings with respect to the 1952–1954 refund period. This interim rate reduction order (which led Panhandle to file and collect, subject to refund, substitute rates designed to yield about $5 million less than the rates originally proposed) was affirmed by the Third Circuit. *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission,* 236 F. 2d 606. Cf. *Federal Power Commission* v. *Tennessee Gas Transmission Co.,* 371 U.S. 145.

Extensive hearings on the second increase, as modified, were resumed prior to the remand in *City of Detroit* and were completed in January, 1957 (Pet. App. A3). In February, 1959, the hearing examiner rendered a decision holding, *inter alia,* that Panhandle had failed to justify an allowance for its own production greater than that arrived at by the traditional rate base method (Pet. App. A3, 25 F.P.C. 805). Upon motion of Panhandle, the Commission, by order of January 14, 1960, reopened the proceeding to permit the company to present additional evidence on that issue (Pet. App. A3, R. 409–417).

The Commission then waived further intermediate decision by the hearing examiner (R. 418–422) and, after oral argument, issued its opinion and order on April 27, 1961 (R. 422–455). At the same time the Commission issued its opinion and order in the remanded proceedings (R. 562–566) on the 1952–1954 rates, in which, having taken no additional evidence, it relied principally on the opinion relating to the rates for the later period.

In its principal opinion, the Commission concluded, with respect to the single issue presented here, that Panhandle had not submitted evidence justifying the claimed commodity value allowance for company-produced gas, which would have increased the allowance for Panhandle's production during the 44-month 1955–1958 refund period by more than $20 million. In so concluding, the Commission rejected the various bases on which Panhandle attempted to justify an allowance in excess of its cost during the agreed-upon test year (the year ending October 31, 1954). It held that evidence of a hypothetical program of future expansion during 1960–1964 was not competent to test the rates in effect from January 1, 1955, through August 31, 1958 (R. 430–431). However, the Commission adjusted the examiner's test year allowance for exploration and development by raising it to the average amount actually spent during the test year and up to the end of the subsequent refund period, noting that the examiner's allowance for exploration and development was less than that actually expended on an annual basis during the 44-month refund period (R. 432–433). It stated, moreover, that if it were "setting rates for the future, we would not necessarily hold a natural-gas company to expenditures confined to the test year" (R. 430).

The Commission also held that Panhandle had not justified the claim of commodity value for its produced gas by adducing evidence to show that the public interest would have been served if it had engaged in additional exploration and development during the

refund period, but that it had not undertaken the hypothetical program because it did not know how much the Commission would allow for its produced gas (R. 428–430, 487–488). The Commission found unpersuasive Panhandle's contention that allowance of a weighted average field price would save future consumers large amounts by furnishing the company an incentive to produce from its own reserves, rather than to buy gas on the market at current prices much higher than the weighted average price. The Commission noted that this claim of future consumer benefits ignored the higher current rates which allowance of commodity value would cause consumers to pay (R. 431).

The court below, in affirming the Commission's allowance of adjusted cost for company-produced gas, held that the Commission was not "obliged on the record made to grant a larger allowance than it did" (Pet. App. A6) and pointed out that the Commission had "left the door open for a more liberal treatment in future years on a more persuasive record" (Pet. App. A6). The court also held that the Commission was certainly "entitled to reject the claim based on hypothetical development costs *not* actually incurred" (Pet. App. A6). The court overruled Panhandle's claim that the Commission had rejected its non-cost evidence through a misunderstanding of the court's *City of Detroit* opinion. In this connection, it commented that the record made "clear that Panhandle would not commit itself to undertake an expanded program of future exploration and development unless the field price or its equivalent was allowed by the Commis-

sion for the gas produced during the refund period" (Pet. App. A6).[3]

ARGUMENT

1. Panhandle argues that the court's decision here (and also its holding in *City of Detroit*) in effect imposed the "cost rate base formula" as the sole means for pricing the company's own production of gas, and therefore conflicted with the same court's later holding in *Wisconsin* v. *Federal Power Commission*, 303 F. 2d 380 (C.A.D.C.), pending on certiorari, Nos. 72, 73, 74, this Term, and with decisions of this Court, such as *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, giving the Commission wide latitude in devising ratemaking formulae (Pet. 9–17). The short answer is that this contention wholly misconceives the basis upon which the Commission used the cost-of-service formula here and upon which the court of appeals affirmed that use. The Commission made clear that it resorted to the cost method in fixing Panhandle's rates not because it felt that the *City of Detroit* case confined it to that method, but simply because it was the only appropriate method of fixing just and reasonable rates for Panhandle *on the record in this case*. While *City of Detroit* can perhaps be read as requiring that in every rate case such as this *some*

[3] The court remanded the proceeding to the Commission for a new determination on the treatment of the profits from the Panhandle's extraction operation at Sneed, Texas, and Liberal, Kansas. In this respect, the court held that it was not clear whether the Commission had acted on an erroneous view of the *City of Detroit* decision. The Commission has not sought review of this determination.

use must be made of the cost rate-base method,[4] the Commission did not adopt that reading in the decisions under review. On the contrary, after referring to the pertinent language of the *City of Detroit* opinion, the Commission stated (R. 429–430):

> * * * The recent case of *Minneapolis Gas Company v. F.P.C.* [294 F. 2d 212 (C.A. D.C.)] indicated that there are many cases in which rate base proof is unnecessary for independent producers with the implication that this might apply likewise to pipeline producers. * * *

Having disclaimed any obligation to adhere to the individual company cost approach in every case, the Commission then disclosed the reason for utilizing that method here (R. 432):

> * * * We think that a new approach is necessary for the pipeline producers as well as the independent producers. In this proceeding, however, we have not established an area price and Panhandle has not shown that it should be allowed the commodity price as an additional allowance over the cost of service. Panhandle must, therefore, depend upon the cost of service evidence with necessary adjustments, as a basis for determining an allowance for its own produced gas.

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[4] See particularly its language (230 F. 2d at 818–819) "* * * though we hold that method not to be the only one available under the statute, it is essential in such a case as this that it be used as a basis of comparison. * * * Unless it is continued to be used at least as a point of departure, the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms 'just and reasonable' to some recognizable meaning."

The statement that "a new approach is necessary for the pipeline producers as well as the independent producers" refers, of course, to the area price method of regulating the rates of independent producers upon which the Commission had embarked[5] in September 1960, a few months prior to the *Minneapolis Gas* decision. The Commission's opinion shows that, after *Minneapolis Gas*, it felt as free in pipeline-producer rate cases as in independent-producer cases to depart from the individual-company cost-of-service approach. In short, the Commission refused to depart from the cost method here by allowing anything more with respect to Panhandle's production business because, upon a careful consideration of Panhandle's evidence and arguments, it concluded that the evidence as to

[5] See *Phillips Petroleum Co.*, 24 F.P.C. 537, affirmed *sub nomine Wisconsin* v. *Federal Power Commission*, 303 F. 2d 380 (C.A.D.A.), pending on certiorari, Nos. 72, 73, 74, this Term, and the simultaneously released Statement of General Policy No. 61-1, 25 Fed. Reg. 9578, 24 F.P.C. 818. We wish to make clear that the policy determination that a new approach is necessary to fixing the rates for the gas production business of pipelines, enunciated in this decision, represented the views of the members of the Commission at that time, and that the present Commission, while giving intensive consideration to the problem, has not yet determined the extent to which the emerging area pricing techniques, which it intends to apply to independent producers, should also be applied to the production activities of natural gas pipelines. See *El Paso Natural Gas Co.*, 28 F.P.C. —, 45 P.U.R. 3d 262, petition for review, C.A. 5, No. 20180. But regardless of how the policy determination is ultimately resolved, the present Commission adheres to the position stated in the opinion here that it is legally free to depart from cost-of-service concepts in pricing a pipeline's gas production to the extent that a record presents an adequate basis for moving to a more appropriate pricing basis.

why something more than cost is necessary" was "insufficient" (R. 430).

The court below so understood the Commission and affirmed it on that understanding, and not on the ground imputed to it by petitioner. Whatever justification there might once have been for petitioner's reading of *City of Detroit* as requiring use of the individual-company cost-of-service method, that reading must now be deemed rejected by the court itself. For the grounds (Pet. App. A6) on which the court affirmed the Commission's order on remand were "that the Commission was not obliged *on the record made* to grant a larger allowance than it did, and that it left the door open for a more liberal treatment in future years on a more persuasive record" (emphasis added). Thus, far from regarding the Commission as legally bound to use the cost method, the court approved the Commission's "leaving the door open." And it endorsed the Commission's basis of decision (Pet. App. A6) as "a delicate balancing by the Commission of the interests of the company, its shareholders, the consumer, and the public." No such "balancing" would have been called for if the Commission had been required to adhere slavishly to the cost method. The opinion goes on to recognize expressly the Commission's freedom of selection of method (Pet. App. A6):

> * * * we are unable to say that the method of computation selected by the Commission was unjust, unreasonable, or not conducive to proper exploration and development. * * *

2. Panhandle further claims that the court below erred in upholding the Commission's exclusion from the cost of service for the 1955–1958 refund period of an additional $20 million which Panhandle believes it should have spent for exploration and development, but in fact did not (Pet. 17–20). This contention is without merit.

Panhandle predicates its need for an additional allowance on the ground that it "overproduced" from, or excessively depleted, its gas reserves during the refund period, and would have depleted them still further if it had not resorted instead to short-term purchases from other pipelines (R. 126–138). It estimated that the expenditures which would have been required to find and develop the reserves needed to maintain the deliverability of its supplies—in substance, to replace the reserves taken from the ground and avoid the short-term purchases from other pipelines—was $5 million for each of the four years of the refund period, or $20 million in all. To produce these revenues, Panhandle urges, the Commission's cost allowance of 4.7 cents per Mcf of company-produced gas had to be supplemented by an additional 5.65 cents per Mcf, making a total allowance of 10.35 cents per Mcf—almost exactly the weighted average field price (10.45 cents per Mcf) computed independently on the basis of actual prices paid in 1954. (Pet. 7.)

As the court below held (Pet. 17–20), the Commission's conclusion that it was "not able to found an additional allowance for the produced gas on a hypothetical program of expansion" (R. 430) was entirely

reasonable. So long as the expenditures had not in fact been made, Panhandle was free to conjecture any size program of hypothetical disbursements it wished, and to select at will the objectives of that program. Here it chose to formulate its claim in terms of the amount needed to "maintain deliverability," but it could just as easily have based its hypothetical exploration and development program on a need for gas for the expansion which its pipeline is now undergoing; or to replace existing long-term gas purchase contracts. The Commission properly held that elements of cost of service which remain so completely the subject of the company's free choice are normally better judged on the basis of known performance rather than conjecture.

It should be emphasized that this is not a case in which the Commission is called upon to prescribe rates for the future on the basis of an estimate of what the company's revenue needs will be. Here its task is simply to determine how much the company should be required to refund for a completed period in the past. To include these hypothetical sums in a rate having no effect beyond the refund period would give Panhandle a return in excess of its actual costs, yet at the same time necessarily fail to provide the contemplated amounts for any future period in which Panhandle might yet demonstrate by performance the reality of its estimated needs.

There are further difficulties in Panhandle's claim to a 10.45-cent per Mcf allowance. As the Commission explained (R. 487), the allowance of the hypothetical costs would place a double burden on the refund-period consumers. For, under the cost-of-

service method used by the Commission, in addition to paying the 4.7 cents per Mcf allowed by the Commission for Panhandle's own production, consumers also reimburse the company for the cost of its short-term purchases of gas from other pipelines. If Panhandle's "deferred charge" theory had been adopted to support the additional 5.75 cents needed to bring that allowance up to the commodity value, the consumer would have been saddled with the combined costs of the hypothetical and actual programs, even though if the hypothetical program had been carried out during the refund period, it would have obviated the necessity for the short-term pipeline purchases (R. 153–155).

There is a further, and more important, reason why the claimed cost of the hypothetical program would not, in any event, support the allowance of the rate contended for by Panhandle. A company's outlay for exploration and development consists of both operating expenses and capital costs. Under its prudent-investment-rate-base cost-of-service method of fixing rates, only some of those costs, such as delay rentals, costs of non-productive well drilling, abandoned leases, and developmental geological surveys are treated as operating expenses. (See, R. 510, 511.) Other costs, principally those related to productive wells, are capitalized.[8] The $20 million that Panhandle claims it should have spent, but it did not, consists of both types of outlays; specifically, it includes productive well capital costs of about $12 mil-

[8] Productive well costs are generally capitalized by the industry. See Smith and Brock, *Accounting for Oil and Gas Producers* (pp. 200–202) (1959).

lion and dry-hole and other operating expenses of about $8 million. Thus, if the program had, in fact, been carried out during the refund period, the Commission would only have included in Panhandle's cost of service approximately $8 million, plus depreciation and depletion of, and return on, the $12 million invested in productive wells. But it would not have allowed the principal of the $12 million capital outlay.

In attempting to justify the inclusion of such capital costs as expenses, Panhandle urges, in effect, that once a company has made an investment that results in a well capable of delivering a fixed amount of gas, the consumer should thereafter not only reimburse the company for all its operating expenses (including depreciation and depletion) plus a fair return on the net investment, but should also pay enough more for the gas to provide the company with the additional capital which would enable it, without further investment or risk,[7] to maintain the same deliverability. In effect, this is nothing other than an application of the discredited "fair value" concept[8] in public utility ratemaking, to the determination of depletion and depreciation charges. It would use "replacement cost," in lieu of the prudent investment actually made in gas reserves to compute such charges. Thus the utility,

[7] In its brief in the court below (at p. 35), petitioner made the unsupported assertion that in the gas production business sufficient revenues must be generated to provide capital for perpetual exploration and development without the addition of new investment capital. Why this should be the case is not apparent, since there is no basis for assuming that at least equity capital cannot be obtained in the market even by independent producers.

[8] See *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 601.

rather than recovering its original capital investment over the course of the useful life of the reserves, recovers instead the amounts necessary, at current (and presumably increased) price levels, to replace the capital assets as they are consumed. The contention that the Commission is bound to use this "fair value" technique, in preference to the "original cost" method, was laid to rest by this Court long ago. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 606–607; *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 593.

CONCLUSION

For the reasons given, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

The Natural Gas Act of 1938, 52 Stat. 821, 15 U.S.C. 717–717w, as amended by Public Law 87–454, 87th Cong. (2d Sess.), S. 1595, approved May 21, 1962, 76 Stat. 72, provides in pertinent part, as follows:

SEC. 4. * * *

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or gas distributing company or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate,

charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the cur-

rently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

* * * * * * *

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No. 614

IN THE

Supreme Court of The United States

October Term, 1962

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

vs.

FEDERAL POWER COMMISSION,
MICHIGAN CONSOLIDATED GAS COMPANY,
COUNTY OF WAYNE, MICHIGAN,
MICHIGAN PUBLIC SERVICE COMMISSION,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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REPLY BRIEF FOR PETITIONER

1. The Commission's Brief in Opposition claims that the decision below here (and the earlier decision in *City of Detroit*) do not conflict with *Wisconsin* v. *Federal Power Commission*, 303 F. 2d 380 (C.A. D.C.), now before this Court as Nos. 72, 73 and 74 this Term, or with the decisions of this Court such as *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591. According to the Commission, Panhandle's assertion of such a conflict is predicated on the misconception that the Commission used the cost of service method here because compelled by *City of Detroit*, whereas the Commission asserts that it used that method here "simply because it was the only appropriate method of fixing just and reasonable rates for Panhandle *on the record in this case*" (italics in original) (Br. in Opp. p. 9).

But the court below did not so read the Commission opinion. This is apparent from the Court's opinion where,

after summarizing briefly its holding in *City of Detroit*, the Court stated (Pet. App. A-3):

> "On April 27, 1961 the Commission issued an opinion and order (269-A, G-1116), modifying its former opinion (269) to accord with our decision in the *City of Detroit* case."

And since the Commission's opinion purports on its face to be applying the "difficult" "test required by the court in the *City of Detroit* case" (R. 432), it is plain that the rule prescribed in that opinion was not disregarded.

Moreover, examination of the Commission's arguments in support of its thesis (Br. in Opp., pp. 9-12) discloses that, despite its protestations to the contrary, the present Commissioners (as well as their predecessors) regard the insistence in *City of Detroit* upon the use of the cost of service formula as of significance. Thus, the Brief in Opposition states (p. 11, fn. 5) that

> ". . . the present Commission adheres to the position stated in the opinion here that it is legally free to depart from cost-of-service concepts in pricing a pipeline's gas production *to the extent that a record presents an adequate basis for moving to a more appropriate pricing basis*" (italics supplied).

This is merely another way of saying that the Commission regards itself as *not* "legally free" to disregard the cost formula in pricing a pipeline's gas production, and as under a legal obligation, at least presumptively, to apply the cost of service formula to pipeline produced gas—or, in other words, that a burden is still on the pipeline to show in each record on a comparative basis that another method is "more appropriate".[1]

[1] Since this requires cost rate base evidence at least as a basis for comparison, it is totally inconsistent with the Commission's exclusion from current independent producer rate proceedings of evidence as to cost of service of individual producers. E.g. *Skelly Oil Co.*, Op. No. 362, Aug. 30, 1962, 28 F.P.C.—. Certainly no such differentiation between pipeline and independent producers is justified as a matter of law.

This Court's decisions in the *Hope* and other cases cited at page 11 of the Petition establish that the Commission is not so confined—that the Commission is not "bound to the use of any single formula or combination of formulae * * *" (320 U.S. at 602), but only to reach a fair and reasonable end result. This must mean that it is not bound to any formula at the commencement of a proceeding, even presumptively. The statute and the *Hope* case require a pipeline to establish only that the rates it is proposing are fair and reasonable in result—without having also to show as a matter of law their relationship to the cost formula.

The theory now espoused by the Commission thus basically embodies the same fundamental error of law as *Detroit*, and this will infect all pipeline rate litigation. The need for setting the Commission straight on such an important question of law clearly warrants review by this Court.

The Commission says that it did not in this case invoke its freedom to "depart from the individual-company cost-of-service approach" (Br. in Opp. p. 11) because "it concluded that the 'evidence as to why something more than cost is necessary' was 'insufficient' (R. 430)" (Br. in Opp., pp. 11-12). But the repeated references to the record in these proceedings as justification for the Commission's use of the cost of service method ignore the fact that this record was made in compliance with the remand of the court below in *City of Detroit*, in which the court had reversed the Commission's pricing of Panhandle's produced gas on a non-cost basis and required the use of the cost rate base method at least as a point of departure. For the Commission now to attempt to support its decision on the ground that a record made under such restrictions is insufficient to justify use of a pricing approach other than cost is obviously to attempt to lift itself by its own bootstraps.

2. The Brief in Opposition (pp. 13-14) asserts that because petitioner had not actively undertaken during the rate period the exploration needed to maintain deliverability, it could "conjecture any size program of hypothetical disbursements it wished. * * *" This is neither accurate in itself nor a fair statement of petitioner's position, which is that the rate payers during any period should pay the actual cost of maintaining the producing company's ability to deliver gas at the same level. The program which Panhandle presented to the Commission was designed to establish rates which would meet this need. There is nothing conjectural about the amount needed to maintain petitioner's ability to deliver gas at the 1955-1958 levels, or about its commitment to undertake the exploration needed for that purpose once the funds needed therefor were authorized by the Commission. The amount required for this purpose is simply not provided through an allowance covering the cost of non-productive drilling and other activities, and a depreciation charge based on the cost of productive wells many of which were drilled many years before (see Petition, pp. 17-18). The public interest in continuous maintenance of an adequate supply of gas requires that fact, not theory, should govern with respect to providing the necessary funds.

The Brief in Opposition says (pp. 15-16) that the Commission should not have allowed the total sum which petitioner claims to have been needed for the maintenance of deliverability. The issue here, however, is not as to how much might have been allowed. That would be for the Commission to consider on a remand. The Commission's error lay in deeming itself bound by the *Detroit* case formula to allow *nothing* additional for this purpose, on the mistaken notion that because the amount was not spent before it was known whether the Commission would make an allowance for it, or how much, it was "hypothetical."

3. The Brief in Opposition filed by Wayne County says that the petition for certiorari is premature because the

entirely separate matter of gasoline extraction profits was remanded to the Commission for redetermination. That issue, upon which petitioner prevailed below, is entirely different and independent from the question as to the method of fixing rates for pipeline produced gas presented by the petition for certiorari. No matter how the former be decided by the Commission, the question before this Court will remain unaffected. The important problem raised by the petition here is thus not "premature" in any sense.

We add only that the same argument was made in opposition to the Commission's petition for certiorari in the *City of Detroit* case, although there the remand to the Commission by the Court of Appeals was on the principal rate question as well as on the gasoline extraction point. If this Court had *then* reviewed and reversed the *Detroit* decision, many years of fruitless, confusing and cumbersome efforts to regulate the pricing of gas production in an impossible way might have been avoided.

Respectfully submitted,

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